



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE INSPECTOR GENERAL

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Theresa S. Shaw
Chief Operating Officer, Federal Student Aid
U.S. Department of Education
Union Center Plaza
830 First Street, NE, Room 112G1
Washington, DC 20202

Dear Ms. Shaw:

This **Final Audit Report**, entitled *Review of Master Promissory Note (MPN) Process for Federal Family Education Loan (FFEL) and Direct Loan*, presents the results of our audit. The purpose of the review was to evaluate the Department of Education's (Department) internal controls over the MPN process for loan disbursements under the two loan programs. Our review covered William D. Ford Federal Direct Loan (Direct Loan) and FFEL program disbursements for award year 2003-2004 (July 1, 2003, through June 30, 2004).

We received oral comments from the Department at our exit conference, on January 28, 2005. We prepared summaries of the comments and provided them to the Department, to verify that its comments are accurately stated in our report. The summaries of the Department's comments are included at the end of the Audit Results and Other Matters sections of this report.

AUDIT RESULTS

We did not identify any significant problems with the Department's internal controls over the MPN process for the two loan programs. According to 34 C.F.R. § 682.206(a)(1) and § 685.201(a)(2)(i) and (b), borrowers must complete an MPN to obtain a FFEL or Direct Loan. To evaluate the MPN process, we performed site visits to the Direct Loan contractor, Education Account Montgomery—Ancillary Services (EAM-AS), and to two FFEL lenders (Sallie Mae and Edfinancial/Edamerica). We selected a random sample of 100 to 110 disbursements at each entity, for a total of 313 total disbursements. To review these disbursements, we examined 213 MPNs, to ensure that the MPN supported the loan disbursements.¹ The three entities were able to provide us with an MPN to support each of the Direct Loan and FFEL disbursements.

The Department monitors the FFEL MPN process through Federal Student Aid's (FSA) Financial Partners Group. This group oversees FFEL guarantors, lenders, and servicers; conducts program

¹ Some of the 213 MPNs supported more than one of the 313 loan disbursements sampled.

reviews; and reviews third-party audits of guaranty agencies and lenders. The Department monitors the Direct Loan MPN process through the Department's on-site monitor, who oversees the MPN work performed at EAM-AS, the Department's contractor for Direct Loans. A second control for the Direct Loan MPN process is through the Common Origination Disbursement System, which includes edits to prevent a loan from being processed without first being electronically linked to an MPN.

Each of the three entities we visited had policies and procedures manuals to ensure that all MPNs are handled in a consistent manner. Through interviews and observations of the actual MPN processes, the audit team determined that each entity followed its procedure manual to ensure that all MPNs are scanned, information is keyed in correctly, and loans are not approved or processed until an MPN is received. All of the entities' vaults are fire protected and personnel have limited access.

Because of inherent limitations in any internal control structure, error or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

We provided written summaries of our results to the Department, and its officials concurred with our results.

OTHER MATTERS

As a part of our review of the MPN process, we examined the record retention policies and the types of disbursement data maintained by the two FFEL lenders. We noted that there is a potential disconnect between the record retention regulations for FFEL lenders and the record retention regulations for schools. The Department's regulations require—

- **FFEL lenders** to maintain their disbursement records for “not less than 3 years following the date the loan is repaid in full by the borrower, or for not less than 5 years following the date the agency receives payment in full from any other source.” (34 C.F.R. § 682.414 (a)(4)(ii)(D) and (a)(4)(iii))
- **FFEL schools** to maintain their disbursement (delivery) records for three years after the end of the award year in which the student last attended the institution. (34 C.F.R. § 668.24(a)(6), (c)(1)(iv)(B), and (e)(2)(i))²

² FFEL lenders and schools are also required to “develop and document a confirmation process in accordance with guidelines established by the Secretary.” (34 C.F.R. §682.401(d)(4)(vi)) The guidance in the Federal Student Aid Handbook directs schools to maintain this documentation indefinitely. (FSA Handbook 2004-2005, p. 2-164) The confirmation process is to be used to ensure that borrowers want subsequent loans made on the MPN. These documentation requirements are applicable only to the process itself, not to individual students' records. We did not examine lenders' compliance with this requirement as part of our audit.

Sallie Mae's written record retention policy for disbursement records exactly mirrors the Department's policy, per 34 C.F.R. § 682.414 (a)(4)(ii)(D) and (a)(4)(iii). Edfinancial/ Edamerica does not have a written record retention policy. It is Edfinancial/Edamerica's practice not to discard any records relating to FFEL loans.

Student disbursement record information that both Sallie Mae and Edfinancial/Edamerica maintain includes the student's identifying information, disbursement dates (date the funds were disbursed electronically to the school), disbursement amounts, and the loan principal amount. In addition, Edfinancial/Edamerica's disbursement record contains the loan sequence number, the loan program, the owner and guarantor of the loan, the original and current balance of the loan, and the code for the bond that funded the loan, if applicable. However, neither of the FFEL lenders receives disbursement records from schools; therefore, lenders have no record of the date on which the loan proceeds were actually delivered to the students or credited to the students' accounts.

Unlike previous promissory notes, MPNs do not require a signature for each of the loans they support. As such, if a borrower claims that he or she did not receive a loan, it may be difficult for the Department to enforce the loan and recover the funds. If the school's three-year retention period has expired, and the lender only has the borrower's MPN, records that document general confirmation procedures, and records of the disbursement of funds to the school (not the borrower), there may not be sufficient documentation to demonstrate that the loan proceeds were in fact disbursed to, or on behalf of, the borrower. FSA should consider how it plans to pursue these cases if the schools do not have the records, and the borrower is not signing for each disbursement on the MPN.

We provided a written summary of this section of our report (Other Matters) to the Department. The Department's officials generally agreed, but asked us to emphasize that the concern noted above does not pertain to the Direct Loan program.

BACKGROUND

The Higher Education Amendments of 1998 (Pub. L. 105-244) amended Section 432(m)(1)(D) of the Higher Education Act of 1965 (HEA), to codify the use of an MPN in the FFEL and Direct Loan programs. Using an MPN, eligible borrowers are able to receive "in addition to initial loans, additional loans for the same or subsequent periods of enrollment through a student confirmation process approved by the Secretary. Such forms shall be used for loans made under this part or part D [Direct Loans] as directed by the Secretary."

The Department, in consultation with the financial aid community, developed an MPN process for multi-year use for student loans in the FFEL and Direct Loan programs. Beginning with the 1999-2000 academic year, Direct Loan student borrowers were required to use MPNs in order to obtain Direct Loans. FFEL student borrowers had the option of using the traditional application or the MPN during the 1999-2000 academic year. In the 2000-2001 academic year, all FFEL student borrowers were required to use an MPN. The MPN process for parent borrowers (PLUS loans) was

implemented for Direct Loans in the 2003-2004 academic year and for FFEL Program loans in the 2004-2005 academic year.

MPNs are designed to be used as single year or multi-year notes. Using the multi-year feature of the MPN, borrowers sign an MPN only once, when they get their first loan. They may obtain additional loans, based on the same MPN, without having to sign another MPN. However, schools and borrowers may decline to use the multi-year feature of the MPN. Schools may require their students to complete new MPNs for each loan, and borrowers may choose to sign a different MPN each time they apply for loans. For loans made under the multi-year feature of the MPN, schools and lenders must develop and document a confirmation process in accordance with the guidelines established by the Secretary. Borrowers participating in the multi-feature of MPNs must also be given a Plain English Disclosure Statement.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objective was to evaluate the Department's internal controls over the MPN process for loan disbursements under the FFEL and Direct Loan programs. The scope of our audit included FFEL and Direct Loan disbursements for award year 2003-2004 (July 1, 2003, through June 30, 2004).

To determine the Department's controls over the MPN process, we—

- Interviewed FSA personnel involved in the MPN process for Direct Loan and FFEL,
- Reviewed FSA policies and procedures relating to the MPN process for the two loan programs, and
- Reviewed select program reviews performed by the Financial Partners Group on FFEL lenders.

To evaluate the MPN process, we visited the Direct Loan contractor and two FFEL lenders to—

- Interview and observe personnel involved in the MPN process,
- Review policies and procedures relating to the MPN process at each entity, and
- Test a sample of FFEL and Direct Loan disbursements to ensure there was an MPN for each disbursement.

To evaluate the record retention practices and types of records maintained for FFEL loan disbursements, we—

- Reviewed the structure of disbursement records at the two FFEL lender locations
- Reviewed disbursement record retention policies at the two FFEL lender locations

The FFEL lenders were selected using the report entitled, "Top 100 Current Holders of FFELP Loans for 2003 and 2002". This report was issued by FSA and ranks the participating lenders by outstanding dollar amount of loans held for fiscal years 2003 and 2002. From the list of top 25 lenders, we selected the number one top lender (Sallie Mae) and a top lender from the middle of the list (Edfinancial/Edamerica).

Using the National Student Loan Data System (NSLDS), we selected a random sample of Direct Loan disbursements and FFEL disbursements for the two lenders selected for review. To verify that the imaged MPNs match the original MPNs, for each site visit we picked a judgmental sample of hardcopy/original MPNs by selecting the first 20 disbursements for MPNs maintained on-site. We compared the hardcopy/original MPNs to its image copy. The sample sizes, number of MPNs, and hardcopy/original MPNs reviewed are shown in the following chart.

| Loan Program/ Entity Reviewed | No. Of Disbursements In Sample | No. Of MPNs Reviewed³ | No. Of Hardcopy/ Original MPNs Reviewed⁴ |
|--|---|---|--|
| Direct Loans EAM-AS | 100 | 80 | 20 |
| FFEL Lender Sallie Mae | 110 | 78 | 20 |
| FFEL Lender Edfinancial/Edamerica | 103 | 55 | 20 |
| Totals | 313 | 213 | 60 |

During the audit, we relied in part on computer-processed data contained in the MPN imaging systems at the three entities we visited. We tested the accuracy and completeness of the images by comparing a sample of the MPN images to its original copy stored in vaults. Based on this test we concluded that the images were sufficiently reliable for use in meeting the audit objectives.

We conducted our audit fieldwork during the period September 2004 through December 2004, and held an exit conference with FSA staff on January 28, 2005. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

ADMINISTRATIVE MATTERS

Statements that managerial practices need improvements, as well as other conclusions and recommendation in this report represent the opinions of the Office of Inspector General. Determinations of corrective actions to be taken will be made by the appropriate Department of Education officials.

³ Some of the MPNs supported more than one of the disbursements sampled. For example, one MPN could be used to support a Fall semester disbursement and a Spring semester disbursement.

⁴ Some of these MPNs were paper hardcopies (EAM-17, Sallie Mae-16, Edfinancial-19) and the remaining MPNs were enotes.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation and assistance extended by your staff during the audit. If you have any questions, please contact Denise M. Wempe, Regional Inspector General for Audit, at 404-562-6477.

Sincerely,

A handwritten signature in black ink that reads "Helen Lew". The signature is written in a cursive, flowing style.

Helen Lew
Assistant Inspector General for Audit Services

cc: William C. Adams, Sallie Mae
Wanda Hall, ED Financial Services